No. 14582

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

THE TIMES-MIRROR COMPANY, a corporation,

Appellee.

On Appeal From the Judgment of the United States District Court for the Southern District of California.

BRIEF FOR THE UNITED STATES.

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Opinion Below.

The findings of fact and conclusions of law of the District Court [R. 33-40] are not officially reported.

Jurisdiction.

This appeal involves excess profits taxes for the calendar years 1943 and 1944 in the amount of $62,357.30 plus interest. The taxes in dispute were paid on October 21, 1949. [R. 35.] Claims for refund were filed on January 26, 1950, and were rejected by notice dated June 27, 1952. Within the time provided in Section 3772 of the Internal Revenue Code of 1939, and on November 20,

1952, the taxpayer brought an action in the District Court for recovery of the taxes paid. [R. 3-22.] Jurisdiction was conferred on the District Court by 28 U. S. C., Section 1340. The judgment was entered on July 29, 1954. [R. 41-42.] Within sixty days and on August 26, 1954, a notice of appeal was filed. [R. 42-43.] Jurisdiction is conferred on this Court by 28 U. S. C., Section 1291.

Question Presented.

Whether the District Court erred in finding and concluding that under the circumstances of this case the cost to taxpayer of microfilming its file of bound copies of back issues of newspapers was an ordinary and necessary business expense and not a capital expenditure.

Statutes Involved.

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [as amended by Sec. 121(a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *

* * * * * * * *

(26 U. S. C., 1952 ed., Sec. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

* * * * * * * *

(2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

* * * * * * * *

(26 U. S. C. 1952 ed., Sec. 24.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.41-3. *Methods of Accounting.*— * * *

* * * * * * * *

(2) Expenditures made during the year should be property classified as between capital and expense; that is to say, expenditures for items of plant, equipment, etc., which have a useful life extending substantially beyond the year should be charged to a capital account and not to an expense account; and * * *

Statement.

The facts were found by the District Court substantially as follows:

Since its first publication of the Los Angeles Times in 1881 taxpayer has maintained bound copies of its printed newspapers. For the period subsequent to 1910 taxpayer has two sets of such bound editions, one of which is kept in a vault in its building and is not used. The other is kept in the vault and is used by taxpayer's officers and employees in the day-to-day operation of its business and

also by the public. For the period prior to 1910 various volumes are missing, due to a bombing of taxpayer's plant in 1910, which also damaged certain of the volumes still on hand. [R. 35-36.]

During 1943 and 1944 taxpayer had these newspapers microfilmed. Of the total of 850,579 pages microfilmed at that time, 30,579 represented issues that were missing in its library and were borrowed for microfilming. There are several volumes of which taxpayer has no copies, either in the bound set or on microfilm. A negative and three positive prints were made. The negative is kept in a vault in its building. One positive print was donated to the Los Angeles Public Library and another to the Huntington Memorial Library. The third is kept by taxpayer in its building near the bound volumes. [R. 36-37.]

The expense of microfilming was $40,000 in 1943 and $44,179.04 in 1944. Taxpayer deducted these amounts in its federal income tax and excess profits tax returns for those years as business expenses. The Commissioner disallowed the full amount for 1943 and $36,830.48 of the 1944 deduction was disallowed upon the ground that the amounts should be capitalized and recovered through amortization or depreciation deductions over a 25-year period; and as a result taxpayer was allowed an amortization deduction of $1,792.70 for the year 1944. [R. 34-35.]

Taxpayer has continued to the present time to microfilm its current newspapers, the filming being done once a month, and the expense thereof is allowed by the Commissioner as an ordinary and necessary business expense. Taxpayer also continues to bind two sets of its current newspapers. [R. 37.]

The court also found that on February 25, 1942, enemy aircraft were reported to have flown over the Los Angeles area and to have been driven off by anti-aircraft defenses. Because of the fear of a bombing, discussions were commenced the following day between the then treasurer, secretary and comptroller of taxpayer (Mr. Downing) and his then assistant, the present treasurer and comptroller (Mr. Bowers) looking to the protection of taxpayer's newspaper files, and from those discussions evolved the determination to microfilm the newspapers. [R. 36.]

The microfilming of the newspapers was not done to conserve space, inasmuch as taxpayer has ample space in its present vault to accommodate two sets of its newspapers for a period of 40 to 60 years in the future, and it can then eliminate one set and thus have sufficient space for some 80 to 100 years in the future. The microfilming was not done to protect taxpayer against deterioration of its bound volumes, to be used in lieu of the bound volumes, because deterioration is not rapid, particularly with respect to the set which is not used. The microfilm is never used by taxpayer whenever there is a bound volume. It is resorted to from two to six times a year by the chief librarian of the Los Angeles Times to answer inquiries from the public regarding a period so long ago that taxpayer does not have a bound volume. It was used occasionally for two years by two members of taxpayer's editorial staff in preparing a column of what had appeared in the Times sixty years earlier, but this use occurred only when bound volumes were missing. Since 1950 the column was moved up to fifty years ago, and since bound volumes are available for all periods since 1910 the microfilm is no longer used for that purpose. The microfilm is difficult to read and cannot be used for

long periods of time without resting. The photographing of the bound volumes makes reading difficult and at times impossible, because the binding was not broken and the material in the middle of the pages is not readable. [R. 37-38.]

The court finally found that the microfilming was not done to, nor did it, improve the original plant of the taxpayer, or increase, extend or prolong its useful life; that it was not done to, nor did it, increase the net or gross income of the taxpayer; that it was done solely as a means of protection against the threatened bombing, to permit taxpayer to maintain its business on the same scale, but not to increase it; that it did not create an asset or capital value; and that it was an ordinary and necessary business expense. [R. 38-39.]

Statement of Points to Be Urged.

1. The District Court erred in finding that, because of the fear of a bombing, discussions were commenced the following day between the then treasurer, secretary and comptroller of taxpayer and his then assistant looking to the protection of taxpayer's newspaper files, and from those discussions evolved the determination to microfilm the newspapers.

2. The District Court erred in its finding that the microfilming was not done to, nor did it, improve the original plant of the taxpayer, or increase, extend or prolong its useful life; that it was not done to, nor did it, increase the net or gross income of the taxpayer; that it

was done solely as a means of protection against the threatened bombing, to permit taxpayer to maintain its business on the same scale, but not to increase it; that it did not create an asset or capital value; that it was an ordinary and necessary business expense.

3. The District Court erred in concluding that the expense of microfilming taxpayer's newspapers was an ordinary and necessary expense incurred in its trade or business under Section 23(a)(1) of the Internal Revenue Code of 1939, and was not a capital expenditure.

4. The District Court erred in holding that taxpayer was entitled to judgment against the United States for refund of excess profits tax and interest paid by it for the calendar years 1943 and 1944.

5. The District Court erred in entering judgment for the taxpayer for the resulting overpayment of excess profits tax and interest paid by it for the calendar years 1943 and 1944.

Summary of Argument.

Ordinary and necessary expenses in carrying on a business are deductible from gross income in order to determine net income. Capital expenditures, however, are not deductible. If an expenditure is for replacements, alterations, improvements or additions which prolong the life of property, increase its value, or make it adaptable to a different use, it is a capital expenditure.

Under normal circumstances the expense of microfilming a set of a newspaper's back issues, running back for sixty

years is clearly a capital expenditure, just as would be the expense of acquiring a duplicate set of those issues.

The present case is one calling for the application of that rule. In finding that taxpayer here incurred that expense solely as a means of protection against the threatened bombing, the court below relied upon testimony of one who did not make the decision or have any direct contact with those who decided to incur the expense of microfilming. In so finding the court below disregarded the overwhelming evidence that that was not the sole purpose of the microfilming. It disregarded the facts that the microfilming was contracted for a year and a half after the false alarm of an enemy air raid, and was begun and completed when there was no reasonable likelihood of an air raid. It disregarded the facts that the microfilming was not limited to taxpayer's existing file of newspapers, that the microfilming continued as a part of taxpayer's normal operations, that the films have been retained and are of some current use.

Even if the purpose of the microfilming were solely to meet a war-time situation, nevertheless the expenditure was a capital expenditure. Deductibility depends upon the nature of the asset acquired. Here taxpayer acquired an asset, permanent in character, which was an addition to its existing plant. In looking at the supposed purpose of the microfilming rather than at the nature of the asset acquired the court below erred. Its judgment should be reversed.

ARGUMENT.

The District Court Erred in Finding and Concluding That the Cost of Microfilming Taxpayer's Set of Back Copies of Its Newspaper Was an Ordinary and Necessary Expense and Not a Capital Expenditure.

The question here is whether the cost to taxpayer in 1943 and 1944 of microfilming its past issues of a sixty-year period is a capital expenditure or a current expense. If it is the former, under Section 24(a)(2) of the Internal Revenue Code of 1939, *supra,* it is not deductible, being an "amount paid out for * * * permanent improvements, or betterments made to increase the value of any property * * *." If the latter it is deductible under Section 23(a)(1)(A) of the Code, *supra,* as "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *."

The general principle to be applied in determining what are capital expenditures is well settled. If an expenditure is for "replacements, alterations, improvements or additions which prolong the life of the property, increase its value or make it adaptable to a different use," it is an addition to capital investment. *Illinois Merchants Trust Co., Executor, v. Commissioner,* 4 B. T. A. 103, 106. This principle has been applied in numerous situations. See, for example, *New Idria Quicksilver Min. Co. v. Commissioner,* 144 F. 2d 918 (C. A. 9th); *Schwabacher v. Commissioner,* 132 F. 2d 516 (C. A. 9th); *Crocker First Nat. Bank v. Commissioner,* 59 F. 2d 37 (C. A. 9th). See also 4 Mertens, Law of Federal Income Taxation, Sections 25.17-25.33;

Holzman, Repairs versus Capital Expenditures, New York University Ninth Annual Institute on Federal Taxation, p. 717.

The distinction between current, deductible expenses and capital expenditures of an exhaustible nature which are to be recouped as deductions, by way of depreciation or amortization, over the entire life of the property, is basic to the taxing system, for the distinction helps to avoid distortions of income. Expenses which contribute to the current year's income are properly deductible in full in that year, thus arriving at a fair reflection of that year's income. However, where the expense is one which has a more permanent effect in that it will contribute to the earning of income in future years as well as in the current year, a fair reflection of income in each year of the period requires that only a portion of the expenditure be deducted in each of the years during which the expenditure is contributing to the earning of income, Quite obviously, if the entire expense were to be deducted in the year when incurred, the net income for that year would be unduly diminished and, of course, since no offsetting deduction would be available to offset the income in later years which might be attributable to the earlier expenditure, the net income of such years would be unduly increased. In short, the income for each year would be distorted.[1]

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[1]Such distortions of income can be disadvantageous to taxpayers as well as to the revenue. Thus, while the present taxpayer finds a present advantage in attempting to deduct in one year the full expenditure which will actually result in economic benefits over a 25-year period, other taxpayers, who do not incur the expense in a high income year, would find it disadvantageous if compelled to take the entire deduction in one year, for they would be deprived of the right to spread the deduction over the entire period when the benefits of the expenditure are actually being reaped.

The statute prevents the deduction of an expenditure which will result in the flow of benefits of a somewhat permanent nature. Specifically, the acquisition of an asset having a useful life of more than one year is not an "ordinary" expense, no matter how "necessary" it may be. One of the functions of the word "ordinary" in Section 23(a)(1)(A) is to distinguish between capital expenditure, *i. e.,* expenses whose benefits project into the future, and expenses whose benefits are exhausted currently. It is only where the expense is both "ordinary" and "necessary" that a deduction is afforded by Section 23(a)(1)(A). And, as we have seen, Section 24(a)(2) contains an explicit prohibition against deducting the kind of expenses which are made for permanent improvements. It is because such expenses are not fully deductible when incurred that Congress permits a deduction for depreciation or amortization to be spread over the useful life of exhausting assets.

The distinction between current expenses and the more permanent kind of capital expenditure is stated in Section 29.41-3(2), Treasury Regulations 111, as follows:[2]

> (2) Expenditures made during the year should be properly classified as between capital and expense; that is to say, expenditures for items of plant, equip-

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[2]This regulation has been in effect since 1920. See Treasury Regulations 45 (1920), Art. 24; Treasury Regulations 62 (1922), Art. 24; Treasury Regulations 69 (1926), Art. 24; Treasury Regulations 74 (1928), Art. 323; Treasury Regulations 77 (1932), Art. 323; Treasury Regulations 86 (1934), Sec. 41-3; Treasury Regulations 94 (1936), Sec. 41-3; Treasury Regulations 101 (1938), Sec. 41-3; Treasury Regulations 103 (1940), Sec. 19.41-3. It has remained the same through repeated reenactments of substantially the same statutory provisions. Accordingly it has the legal effect of a Congressional enactment. *Helvering v. Reynolds Co.,* 306 U. S. 110, 116; *Morgan v. Commissioner,* 309 U. S. 78, 81; *Commissioner v. Laguna Land & W. Co.,* 118 F. 2d 112 (C. A. 9th); *Schwabacher v. Commissioner,* 132 F. 2d 516, 519 (C. A. 9th).

ment, etc., which have a useful life extending substantially beyond the year should be charged to a capital account and not to an expense account; and

* * * * * * * *

See also, Mertens, *supra,* Section 25.17, where the rule is stated:

> An item of expenditure, in order to be deductible under this section of the statute providing for the deduction of ordinary and necessary business expenses, must fall squarely within the language of the statutory provision. This section is intended primarily, although not always necessarily, to cover expenditures of a recurring nature where the benefit derived from the payment is realized and exhausted within the taxable year. Accordingly, if the result of the expenditure is the acquisition of an asset which has an economically useful life beyond the taxable year, no deduction of such payment may be obtained under this provision of the statute. In such cases, to the extent that a deduction is allowable, it must be obtained under the provisions of the statute which permit deductions for amortization, depreciation, depletion, or loss.

It is clear that under ordinary circumstances the expense of microfilming a complete, or nearly complete, set of a newspaper's back issues for a period of sixty years in the past is a capital expenditure. The acquisition of such an asset having a useful life of 25 years represents the acquisition of a capital asset within the rule stated in the Treasury Regulations. This would be of the same nature as the acquisition of a library, or, more closely analogous, as obtaining another bound set of the newspapers. We do not suppose that if instead of microfilming

the bound volumes taxpayer had acquired from some other source a third file of its back issues taxpayer would argue that the cost of that set was in its nature a current expense. That the duplicate sets are on microfilm instead of on newsprint does not change the nature of the expenditure or make them any less of an addition to the property. As the Commissioner stated in his ruling, I. T. 3732, 1945 Cum. Bull. 88 (Appendix, *infra*), any expenditure for microfilming such files would of necessity be expenditures for the improvement or betterment of an existing facility.[3]

The court below, however, apparently thought that the present case presented unusual circumstances justifying a departure from the normal rule. It found that from the

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[3]In his ruling the Commissioner also stated that the costs of periodic microfilming of future editions are deductible as ordinary and necessary business expenses. While such expenditures might also be considered as capital expenditures in the sense that they are for assets which have a long useful life, the periodic occurrence of this expense justifies their deduction out of practical considerations since the result is about the same as would ensue if the costs were being amortized on the basis of each year's expenditures. The situation is analogous to the costs of a set of law books. A lawyer acquiring at one time a full set of the United States Reports purchases a capital asset which should be depreciated. Thereafter, as he purchases its current volumes, it is more practical to permit the current year's costs to be deducted instead of amortized for the computations would become too complicated and the net tax result would not be sufficiently different to justify these complications. The distinction between microfilming back files and microfilming current issues is also somewhat analogous to the distinction between the cost of building a newspaper's circulation structure, which is capital expense (*Meredith Pub. Co. v. Commissioner*, 64 F. 2d 890 (C. A. 8th); *Public Opinion Pub. Co. v. Jensen*, 76 F. 2d 494 (C. A. 8th)), and the expense of maintaining the circulation, which is currently deductible (*Perkins Bros. Co. v. Commissioner*, 78 F. 2d 152 (C. A. 8th); *Willcuts v. Minnesota Tribune Co.*, 103 F. 2d 947 (C. A. 8th)).

In any event the files here involved cannot reasonably be considered current records.

discussions on February 25, 1942, following the report of enemy aircraft in the Los Angeles area evolved the determination to microfilm the newspapers [R. 36] and that it was done solely as a means of protection against the threatened bombing. [R. 38-39.] We submit that even if the findings are taken as correct, the conclusion of the court below is erroneous as a matter of law. We shall also show that these findings are clearly erroneous in any event.

The court erred as a matter of law in concluding [R. 39] that the expense was not a capital expenditure because it was incurred to protect the files against threatened bomb damage. The governing consideration was quoted by this Court in *Crocker First Nat. Bank v. Commissioner,* 59 F. 2d 37, 39, from *Parkersburg Iron & Steel Co. v. Burnet,* 48 F. 2d 163, 165 (C. A. 4th), as follows:

> * * * whether or not a given outlay actually results in ultimate advantage to the taxpayer does not determine whether such outlay is to be treated as representing a permanent improvement; that is, a capital expenditure, or merely current upkeep, that is, repairs. The true test is rather the nature of the expenditure in and of itself, for, as the government rightly contends, an alteration may be made expressly for the purpose of increasing the value of a given property; and, though it may fail to accomplish that purpose, it nevertheless may remain a capital expenditure. The extent and permanency of the given alteration are indicative of its true character.

The *Parkersburg* case involved wartime changes. Taxpayer was a manufacturer engaged in a sheet mill business. Its plant was adequate and satisfactory for its business, which in 1918 was principally the production of

articles under Government war contracts. At the suggestion of Army engineers, in order to improve lighting conditions, it made extensive alterations in its plant. The productivity of the plant was not increased by reason of these alterations. Assuming that the alterations did not increase the efficiency, productivity or value of the plant, and that taxpayer had been put to a decided disadvantage by reason of the alterations, the Board of Tax Appeals held the expenditures for alteration not to be a current expense. The court approved, finding them to be a capital expenditure.

In that case, as here, the capital asset was a permanent change, and had not been abandoned. *Russell Box Co. v. Commissioner,* 208 F. 2d 452 (C. A. 1st), goes further. There the taxpayer in 1942 erected a substantial wire mesh fence around its plant, apparently at the suggestion of Government inspectors, to provide a tenant of its buildings, engaged exclusively in war work, with greater protection from sabotage. The fence was taken down sometime after the war because it proved to be a nuisance in that it impeded access to the plant both by rail and by truck. The court held the fence to be a capital improvement while it lasted, even though taxpayer may have planned to tear the fence down as soon as the war emergency was over, and did so, and even though the fence may not in the long run have enhanced the value of the property.

That those cases involved the physical structure does not, of course, mean that the principle is limited to physical structures. A trademark is a capital asset (*Seattle Brewing & Malting Co. v. Commissioner*, 6 T. C. 856, 872-873, affirmed, 165 F. 2d 216 (C. A. 9th)); the cost of de-

fending title is a capital expenditure (*Schwabacher v. Commissioner*, 132 F. 2d 516 (C. A. 9th)).

Taxpayer here made expenditures to acquire a microfilm negative and prints of its set of back issues, and to supplement this set with other issues. Even if it had done so solely in order to avoid a possible destruction of its files in the event of bombing, the expenditure would have been a capital expenditure. Even if it had abandoned the films after the war they would have continued to be a capital asset while they existed. In fact, however, the prints are retained and continue to be used and taxpayer continues to microfilm its current issues.

The court below also seemed to be influenced by its finding [R. 38-39] that the microfilming did not increase the net or gross income of the taxpayer but permitted it [R. 39] "to maintain its business on the same scale, but not to increase it." These findings do not justify the conclusions stated in the same paragraph, namely that the expenditures "did not create an asset or capital value" and that the expense was [R. 39] "an ordinary and necessary business expense."

The expenditure did create an asset, the microfilms; and that asset does have a useful life of 25 years. Even if the acquisition of the asset only maintains the business on the same scale, that does not change the character of the asset or make the expense an ordinary one. It would be a novel rule indeed which would permit the cost of a permanent asset to be deducted as a business expense merely because it maintained rather than increased the business income. The microfilms were an addition to the capital plant. They did not serve merely to maintain the

usefulness of the existing plant. *Cf., American Bemberg Corp. v. Commissioner,* 10 T. C. 361, affirmed, 177 F. 2d 200 (C. A. 6th); *Roundup Coal Mining Co. v. Commissioner,* 20 T. C. 388; *Illinois Merchants Trust Co., Executor v. Commissioner,* 4 B. T. A. 103. They were not in the nature of repairs to the bound volumes. Instead they were an improvement changing the nature of taxpayer's plant and equipment.

Although we do not believe that they have any relevant significance in a proper classification of the asset, it may be observed that the findings relating to the reason why the microfilming was undertaken are erroneous because they are based on the testimony of a witness who did not know the reason for the final decision to microfilm and because they are contrary to the circumstances shown by the record as a whole.

The sole witness on this part of the case was Harry W. Bowers, in 1942 the auditor of taxpayer. [R. 50-51, 62.] He testified that on February 25, 1942, after the false report of enemy aircraft, he discussed with his superior, Mr. Downing, the danger to the files from a possible bombing. [R. 56.] We do not question this testimony or his testimony that from that "it resulted eventually in the contract of having the back issues microfilmed." [R. 57.] And if in its finding that from these discussions "evolved" the determination to microfilm the newspapers [R. 36] the court below merely meant that these discussions first raised the question and thereafter by a process of evolution a decision to microfilm was eventually made, such a finding is justified by the testimony. But if the court in this finding means to support its later finding that the microfilming was done solely as a means

of protection against the threatened bombing [R. 38-39], we submit that the court erred. *Post hoc ergo propter hoc* is not a sufficient basis for a finding as to the business purpose of the microfilming, where the circumstances not only do not support the finding but are contrary to it.

The witness, Bowers, was unable to furnish the link between his discussion with Downing and the eventual decision. He did not confer with the directors on this question [R. 69]; he was not present at any discussions of the directors [R. 70]; he doubted that the directors made the decision, and thought it was made by Norman Chandler [R. 70];[4] but he never discussed it with Mr. Chandler or with anyone but Downing. [R. 81.]

Furthermore, the other evidence in the record, as to timing, extent of microfilming, and current practice, is contrary to the inference that the microfilming was a temporary measure solely as a protection against the threatened bombing.

Conceding that on February 25, 1942, Mr. Bowers and Mr. Downing were concerned about the bombing and assuming that this sparked the idea of having the files microfilmed, it is significant that the contract for microfilming was not entered into until July, 1943, a year and a half later, work did not start until September, 1943, and was not completed until the fall of 1944. [R. 68.] By September, 1943, the Japanese fleet had been crippled by the battles of Coral Sea, Midway, Solomons, and Bismarck Sea. The Japanese had evacuated Guadalcanal and the American counteroffensive was under way. In Europe

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[4]Mr. Chandler is not identified in the record. He was at the time manager of the newspaper.

the Allies had landed in Italy. It is difficult to conclude that at that time the expense of microfilming would have been incurred as a purely temporary measure to meet the threat posed by a false alarm a year and a half earlier. It is even more difficult to believe that the expense for that purpose would have been allowed to increase during the period of Japanese retreat in 1944.

Furthermore, if the purpose were merely to safeguard the newspaper's existing files, there was no need to microfilm the 30,579 pages missing in taxpayer's bound sets but available from the State Library at Sacramento and two other libraries. [R. 66.] For the period subsequent to 1910, too, the claimed purpose could have been achieved by storing the duplicate set of back issues, which is not used, in a safer place, rather than incurring the expense of microfilming.

That the microfilms are used relatively little compared to the bound copies [R. 37-38] does not show that the microfilming was a temporary expedient. On the contrary, not only does taxpayer currently microfilm its newspapers, in addition to the bound copies [R. 87-88], but efforts are being made to find missing issues of which taxpayer has no copies, either bound or microfilmed, in order to make the file complete. [R. 92.] It seems fairly plain that taxpayer, in microfilming its back issues, was acquiring an asset which would be helpful in its business for a fairly long period of time. Such an asset is clearly a capital asset.

Conclusion.

The judgment of the District Court should be reversed.

Respectfully submitted,

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APPENDIX.

I. T. 3732 (1945 Cum. Bull. 88):

Internal Revenue Code.

In the case of a newspaper publisher, the cost of microfilming newspaper files which may reasonably be considered current records and the cost of periodic microfilming of future editions are deductible as ordinary and necessary business expenses for the year in which such expenditures are paid or incurred, but the cost of microfilming old newspaper files which are not classifiable as current records should be capitalized and recovered through depreciation allowances.

Advice is requested whether amounts paid or incurred by newspaper publishers with respect to the microfilming of newspaper files and for periodic microfilming to keep such files current are deductible as ordinary and necessary business expenses for Federal income tax purposes.

The old files of newspapers maintained by newspaper publishers represent libraries which are used by the journalistic staffs of such publishers in preparing articles for publication. In many instances the oldest files are deteriorating rapidly and storage space is practically exhausted. Inasmuch as newspaper files are permanent records, it is important that such files be safeguarded as far as possible against deterioration and the hazards of fire, flood, etc. The substitution of microfilm copies for the original records enables newspaper publishers to conserve space and insures the permanency of their files. Any expenditures paid or incurred for microfilming the

files would of necessity be expenditures for the improvement or betterment of an existing facility of the business.

Section 23(a)(1)(A) of the Internal Revenue Code provides that in computing net income there shall be allowed as deductions:

> (A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.

Section 29.23(a)-1 of Regulations 111 provides that business expenses which are deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under section 23(b) to section 23(z) of the Code and the regulations thereunder. The principle is well established that expenditures, in order to be deductible as business expenses, must be both ordinary and necessary in the taxpayer's trade or business during the taxable year for which the return is made. (See *Welch v. Helvering,* 290 U. S. 111, Ct. D. 755, C. B. XII-2, 112 (1933).) Section 24(a)(2) of the Code provides in part that no deduction shall in any case be allowed in respect of any amount paid out for permanent improvements or betterments made to increase the value of any property. Section 29.41-3 of Regulations 111 provides in part that expenditures made during the taxable year should be properly classified as between capital and expenses, *i. e.,* expenditures for items of plant, equipment, etc., which have a useful life extending substantially beyond the year should be charged to a capital account and not to an expense account.

In view of the foregoing, it is held that in the case of a newspaper publisher the cost of microfilming newspaper files which may reasonably be considered current records and the cost of periodic microfilming of future editions are deductible as ordinary and necessary business expenses for the year in which such expenditures are paid or incurred, but the cost of microfilming old newspaper files which are not classifiable as current records should be capitalized and recovered through depreciation allowances under section 23(1) of the Internal Revenue Code.